

**TUCSON SUPPLEMENTAL RETIREMENT SYSTEM
BOARD OF TRUSTEES
MEETING MINUTES**

DATE: Thursday, June 30, 2016
TIME: 8:30 a.m.
PLACE: Finance Department Conference Room, 5th floor
City Hall, 255 West Alameda
Tucson, Arizona 85701

Members Present: Michael Coffey, Acting Chairman
Kevin Larson, City Appointee
Rebecca Hill, HR Director
Jorge Hernández, Elected Representative
Karen Tenace, Deputy Director of Finance

Staff Present: Neil Galassi, Pension Administrator
Bob Szelewski, Pension Lead Analyst
Dmitriy Adamia, Administrative Assistant

Guests Present: Catherine Langford (via telephone)
Stephen J. Arnoldi, City of Tucson Employee

Absent/Excused: Robert Fleming, Chairman
John O'Hare, Elected Retiree Representative

Michael Coffey called the meeting to order at 8:35 AM.

A. Consent Agenda

1. Approval of May 26th, 2016 TSRS Board Meeting Minutes
2. Retirement ratifications for June 2016
3. May 2016 TSRS Budget Vs Actual Expenses

Chairman Coffey asked for a vote on the approval of the Consent Agenda. A motion to approve the Consent Agenda was made by Kevin Larson, 2nd by Jorge Hernandez and passed by a vote of 4-0 (Chairman Coffey did not vote, Robert Fleming and John O'Hare absent/excused).

B. Disability Applications *

1. Stephen J. Arnoldi

Kevin Larson stated the approval from the Social Security Administration was an important factor in the disability application.

Chairman Coffey stated the approval from Social Security Administration is not the deciding factor but it is an important factor the TSRS Board considers.

Rebecca Hill stated Mr. Arnoldi has submitted paperwork for long-term disability.

A motion to approve the disability retirement application of Stephen J. Arnoldi was made by Kevin Larson, 2nd by Rebecca Hill and passed by a vote of 4-0 (Chairman Coffey did not vote, Robert Fleming and John O'Hare absent/excused).

C. Investment Activity Report

1. TSRS Portfolio Composition, Transactions and Performance Review as of May 31st, 2016

Neil Galassi asked if the Board had questions about the reports presented.

Chairman Coffey asked if this reporting format is the new standard.

Mr. Galassi answered in the affirmative.

Mr. Galassi stated the executive summary was prepared before the Brexit and he focused on a few factors regarding the Brexit.

Mr. Galassi stated the United Kingdom voted to leave the Euro Zone. This topic was touched upon by Callan in the last Board meeting as a potential event. As the Market anticipated the vote to leave would fail, the market rallied the day before and the portfolio saw a 50 basis point increase equating to about a \$4.5M during the week leading up to the vote. Two days following the vote the portfolio declined approximately 1.7% from the balance as of the beginning of the week. Since Monday of this week the portfolio has gained back about 90 basis points. The initial losses were related to short term market reaction and correction from the previous rally. During discussions with Callan, they do not believe this is a Black Swan event, they would classify this as simply an event, as losses were not catastrophic and the market began to seemingly change trajectory from the events of the morning later in the day. Overall the largest one day market losses were around 3% - 3.5%

Chairman Coffey asked in terms of asset allocation he is interested in the effect on the Boards International Equity investments.

Mr. Galassi stated staff has received communication from all three of the Boards International Equity managers. All three managers have indicated they are focused on the best interests of their clients and are actively monitoring the negotiations. If the Euro Zone exit is done in an accommodative manner it may encourage other States to consider leaving. If the negotiations are punitive other States may look at it as a teachable moment and be more inclined to stay in the Euro Zone. Our recent increased exposure to international equity did not make a significant difference in the losses as the majority of domestic companies we have been invested in have international operations, therefore domestic equities saw similar losses. Going forward there is uncertainty, it will take years of negotiations for the exit to be finalized.

Mr. Galassi stated from an actuarial prospective this is an event that caused a loss near fiscal year end, which is the measurement date for our actuarial valuations. It appears as of June 30, 2016 the Portfolio could potentially be down somewhere in the 3% to 4% range from the June 30, 2015 Market value of \$735.6M. Although from a market basis prospective the returns may be near zero, the actuarial value of the assets may increase. This is due to the 5 year actuarial smoothing of investment gains/losses in order to lessen the impact of potential events like near fiscal year end like the Brexit, and have contribution rates remain more stable. As of June 30, 2015, the actuarial value was \$706.8M which was approximately \$28.8M different from the market value as of that date. With the 5 year smoothing only 1/5th of losses from this fiscal year would affect the portfolio on an actuarial basis. It appears the years representing the other 4/5th may potentially mitigate losses resulting from the Brexit in the 2016 valuation.

D. Administrative Discussions

1. Funding Policy Revision: Redline Version – Catherine E. Langford

Catherine Langford stated when the Board was working on the proposed code changes that we were putting together in connection with the IRS application last fall; the board reviewed and revised the funding policy in a fairly significant manner in connection with those proposed City Code changes. The Overall goals of that funding policy revision last year were to incorporate and lock in this concept of setting the City's contributions to the system at a floor of 27.5% and building in on a permanent basis our rounding policy. The goal for the Board at that time was to get the funding policy incorporated into the actual code language, so we could get rid of the distinction between the actuarially required contribution and the Board's recommended contribution. When the contributions were taken to Mayor and Council for approval along with code changes, we were able to accomplish some of the needed code changes but we were not able to accomplish having the funding policy changes written into City Code. The Mayor and Council retained our current structure, where we have a baseline required contribution which is based on the actuarial calculation, and that is what the city has required under the code to appropriate and pay over into the system. She suggested making the funding policy consistent with the code changes that were actually approved by Mayor and Council last year. What the Board has done in this draft is remove the provisions that anticipated code changes, and anticipated that we would be able to replace in the code the actuarially required contributions with the board recommended contributions. We have taken that language out of the funding policy that reflected code changes that were not made, but left in there the Board's goal to encourage and recommend additional funding until the system is fully funded.

Chairman Coffey asked are administrative expenses factored in the ARC.

Ms. Langford answered administrative expenses are not factored into the ARC. Historically administrative expenses have reduced our investment gain. That was discovered that last year and it was decided that we should add the administrative expenses as a separate item in the calculation of the required actual contribution recommendation. The intent is to recommend to the City that they pay the administrative expense cost for the year, and the contributions be rounded under the rounding policy upon adoption of the contribution rate for any particular fiscal year. In the past administrative expenses were not accounted for as a separate line item in the Annual Actuarial Evaluation; they were simply just an offset to investment gains. Administrative expenses are typically in the neighborhood of \$700,000 a year, they are part of the administrative budget, and that number is separately communicated to the actuary. This funding policy change last year with regards to administrative expenses was our effort to make that more transparent and to provide a more accurate reflection of the true investment results.

Karen Tenace stated the funding policy is a complicated read from a layperson's perspective. This policy will be published on our website, potentially plan members could be reading it, the public, and ward offices. Laced throughout this entire policy are terms like the ARC, ADC, calculated rate, and charged rate. The Board should consider not only tightening it up and reflecting what is actually occurred, but also tightening up the terminology. Additionally looking at other funding policies it is very clear and conspicuous in their policies the purpose is to fully fund the plan, to minimizing volatility for the employer and the employee, and to mitigate risk of intergenerational equity issue. Under our purpose we defined what the core elements of the ADC are. She believes this could be cleaned up to be an easier read.

Rebecca Hill stated most of the information is defined in the body of the document and there are visible attempts to be concise and to condense the document. It is a complex issue and most people probably are not going to understand it.

Kevin Larson asked do we tend to get a fair amount of questions on the funding policy and where is this policy posted.

Ms. Hill answered the Board has staff that can address those questions when they surface.

Mr. Larson stated he believes the funding policy is a legal document, which is why the Board has attorneys draft it to cover the legal bases. He believes it certainly could be better written in terms of being reader friendly. He asked do our employees or the public ever look at this to any extent and do we get follow-up questions.

Ms. Tenace stated this policy does get attached to Mayor-Council communications because we refer to it. We have the IAPC subcommittee looking at it and we will be answering questions regarding the funding policy when that committee meets. On occasion it does get reviewed and if we are starting from a confusing read versus something potentially clearer, we are starting off on better footing in terms of explaining something that is already complex.

Chairman Coffey stated he agrees it is a complex legal document and it may need to be complex to cover all of the legal bases. In parallel to this the Board could add documentation generated for our members that is easier to read but not necessarily change legal policy documents.

Chairman Coffey and Ms. Hill stated maybe a page that states "How to Understand the Funding Policy".

Ms. Langford stated the Board put the funding policy document together 4 or 5 years ago because we needed to fill the gaps. We had code provisions that were very basic, we had the actuary evaluation report, and we did not have in writing a policy that captured the assumptions that were being used and the methodology. The Funding Policy evolved from a very technical standpoint, she thinks that if the Board were comfortable with the substance of the policy, she would recommend that the Board adopt the Funding Policy document draft presented here. She would then bring back another draft of it that is intended to be a more plain English version, and she thinks it can be accomplished in this document. Even if we had a more readable purpose section and introduction we can ease people into the technical nature of what we are covering here. She would like to have the basic principles adopted before we close out our current fiscal year, so that this funding policy which gets wrapped into the evaluation is accurate. The one that we adopted last year simply does not correspond to the code any longer.

Ms. Tenace stated she is onboard with this idea and in the following days she will come up with a few suggestions on how to make the Funding Policy a little bit more readable.

Mr. Larson stated he would support approving the Funding Policy. Additionally he would prefer a summary page that is focused on what is really important to the reader. He does not believe it is worth the time to try and go through these five pages and make it reader friendly because it is a lot of detail.

Ms. Langford stated we could start the funding policy with an Executive Summary page and leave the funding policy technical.

Chairman Coffey asked for a vote on the approval of the Funding Policy Revision. A motion to approve the Funding Policy Revision was made by Kevin Larson, 2nd by Rebecca Hill and passed by a vote of 4-0 (Chairman Coffey did not vote, Robert Fleming and John O'Hare absent/excused).

2. Valeant Pharmaceuticals Litigation – Catherine E. Langford

Catherine Langford stated Valeant is an international pharmaceutical corporation that is under investigation and the subject of several lawsuits for major stock losses. The company has lost more than \$80B in market capitalization since inception of the investigation. Market losses were generated by what are alleged to be fraudulent pricing practices on certain drugs manufactured by Valeant. There is a large investor shareholder class action lawsuit that is pending in district court in New Jersey. The law firm that is doing the security monitoring for the Board, Robbins, Gellar, Rudman, & Dowd (RGRD) has identified a loss that the system suffered relating to Valeant securities purchased in March of 2015. The loss is estimated at half a million

dollars for the system. The class action lawsuit has been pending and it deals with securities that were purchased over a two year period of time. The reason the Board was contacted about it by RGRD is the fact that the securities the system purchased in March of 2015 were part of a separate offering in which RGRD was not able to identify any other investor in their database who purchased shares directly in that March 2015 offering. As a result, they did not have another plaintiff available to represent the class of investors that bought shares in that March 2015 offering. Therefore, they approached the city and the system about becoming a named plaintiff with respect to that March 2015 offering in the current class action lawsuit. The lead plaintiff for the class action lawsuit is TIAA-Cref, they have the largest overall losses but they did not buy any securities in that particular March 15 offering. Staff and legal counsel had a series of conversations with the attorneys who are working on the class action lawsuit, and the City Attorney took the matter to Mayor and Council. Mayor and Council agreed and approved the named plaintiff position for the City. Given provisions in the City's Charter, the suit is written to have the City, on behalf of the system, be the named plaintiff. Although the system's losses are approximately \$500,000, the losses for that entire class of investors from the March 2015 offering is about a billion dollars. It is significant because by bringing the System's claim into the suit as a named plaintiff, the attorneys are able to bring in a number of other parties as defendants for example, underwriters and insurance companies. The updated consolidated complaint was filed with the court last June 24, 2016, and that is the first time that the city or the system's name has appeared in any of the proceedings. RGRD is the main attorney on the case and we are going to be working with them on both the Volkswagen litigation and the Valeant litigation. The System is positioned differently in the Volkswagen litigation as the System is a class member, and is not expected to have anything to do in terms of work or participation in the active litigation. In the Valeant litigation it is different because the system, or rather the city on behalf of the system, is serving as a named plaintiff and it is likely that we will have to produce some discovery. However, we have been assured that will be minimal because discovery will be related to did you buy the securities and when and through which investment manager. The attorneys have already compiled all of that information; the securities were purchased through T. Rowe Price and RGRD is already working with T. Rowe Price. The other possibility is that the City or the System may have to make someone available for a deposition in the litigation with regard to the subject of the System's purchase of those shares. It is going to be done on a contingency basis so that the attorney's fees and all of the cost of the class action will be recovered only from any judgment or settlement that the attorneys achieve. This would all be subject to court approval. The litigation has a potential upside of recovering the losses to the System.

Kevin Larson stated he does not believe there is much of a downside to this litigation.

3. Disability Audit Results

Neil Galassi stated consistent with Tucson City Code Section 22-39(f), TSRS must complete a disability audit review of those members that have not reached the normal retirement age or 80 service credits. There are 151 retirees or beneficiary survivors receiving a disability type benefit, of the 151, there were 44 audits sent out in May of 2016 with a certified, return receipt requested. Responses had been received from 40 of the retirees audited. After attempts to locate the most recent information within the means of TSRS staff we were unable to locate 4 individuals. After consultation with legal counsel, Individuals who have failed to respond and/or have failed to ensure TSRS records contain their most recent information can be deemed to not be in compliance with TCC 22-39(f). We recommended discontinuing the benefits to the four non-compliant individuals as an attempt to garner their attention. This action is provided for in the Tucson Code. The audit responses required completion of a simple affidavit indicating whether the retiree had earned any income. The audited individuals were not new or recent retirees. If the Board approves the recommendation the action would affect with the July pension check of the non-compliant individuals. This action has been taken in the past for isolated cases and the reason for the audits was if the individual receiving disability benefits has another source of income, adjustments may be required on their pension checks. This action has been successful in the past.

Rebecca Hill asked if the pension check was discontinued, and the retiree contacts the pension office with the required affidavit than would their pension check be reinstated.

Mr. Galassi answered in the affirmative, once staff had an opportunity to evaluate the information provided in the affidavit.

Kevin Larson asked if the retiree does not contact the pension office for six months, would the retiree receive back pay for the six months.

Mr. Galassi answered in the affirmative. The retiree would be paid retroactively.

Chairman Coffey asked how the 44 retirees were selected out of the 151 in total.

Mr. Galassi stated the retirees that have not reached normal retirement age or attained the 80 service credits.

Chairman Coffey clarified that only 44 out of the 151 have not reached normal retirement age or 80 service credits.

Mr. Galassi answered in the affirmative, and all 44 were audited.

Chairman Coffey asked to clarify if the retiree's income needed to be verified.

Mr. Galassi answered per the City code if the retirees earned income exceeded 50% of their average final compensation than their benefit would need to be evaluated for adjustment.

Chairman Coffey asked in the audit communication sent to the 44 disability retirees, did staff inform the retirees that failure to comply would result in a termination of their benefits.

Mr. Galassi answered in the affirmative.

Catherine Langford stated the reason the income verification requirements may not be familiar to some of the Board members is because they only apply to employees that qualify for disability retirement prior to July of 2009. This is a requirement that is being carried over from an older version of the City code.

Mr. Larson asked what sort of documentation are the retirees required to provide.

Mr. Galassi answered the retirees are required to provide proof of income such as a W2 form and/or a tax return. Retirees also provided 1099R forms to show no earned income.

Chairman Coffey asked for a vote on the approval of discontinuing the benefits to the non-compliant individuals. A motion to approve discontinuing the benefits to the non-compliant individuals was made by Kevin Larson, 2nd by Karen Tenace and passed by a vote of 4-0 (Chairman Coffey did not vote, Robert Fleming and John O'Hare absent/excused).

Mr. Larson asked how does staff determine if a retiree has passed away.

Mr. Galassi stated staff uses a system called "Small World", it is how staff accesses the Social Security database. Bob Szelewski checks the database on a daily basis and we do rely on being contacted by the beneficiaries. Staff has been actively working with Small World, the ASRS, and other jurisdictions to improve the process even though we are at the very early stages of that process.

Bob Szelewski stated typically the population is really minimal. We have two groups of people, the ones that had left a survivor benefit, in that case we usually hear from them rapidly. It is the second group, the single life pensions that typically would be the ones that might go outside of a 30 day or 60 day window and then we have a process in place to recapture funds if there have been overpayments.

E. Articles for Board Member Education / Discussion

1. PIMCO – The Global Outlook: Stable But Not Secure

Neil Galassi stated the Global Outlook article was written and printed before the Brexit. PIMCO's outlook may have changed after the Brexit. The article discussed PIMCO's views of global economy, mainly in regards to China and the future of the global market. Mr. Galassi will be providing the Board members more educational articles in the future.

F. Call to Audience – None heard.

G. Future Agenda Items

1. Education Plan for New Staff and Trustees
2. Duties and Selection of Advisory Board
3. Hiring an Intern to Free Staff for Education
4. TSRS Board Annual Evaluation of Staff and Consultants
5. Formal Evaluation of Active Managers – 1.5% over benchmark over a given period
6. RFQ for Actuarial Services
7. Action Plan for Black Swan Events
8. Would It Be Better to Index the Whole Fund

Mr. Galassi stated Robert Fleming and staff will work together to prioritize and schedule future agenda items. He also indicated he will meet with Board members individually to gather their opinions about possible future agenda items.

H. Adjournment - 9:20 AM.

Chairman Coffey asked for a vote on the approval of the Adjournment. A motion to approve the Adjournment was made by Kevin Larson, 2nd by Rebecca Hill and passed by a vote of 4-0 (Chairman Coffey did not vote, Robert Fleming and John O'Hare absent/excused).

Approved:


Robert Fleming
Chairman of the Board

8/25/16
Date


Neil S. Galassi
Pension Administrator

8/25/2016
Date